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Supreme Court, U.S.
FILED
APR 28 2009
OFFICE OF THE CLERK

No. 08-1207

IN THE

Supreme Court of the United States

GEOFFREY, INC.,

Petitioner,

v.

COMMISSIONER OF REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Judicial Court of Massachusetts

BRIEF OF *AMICUS CURIAE* INSTITUTE FOR PROFESSIONALS IN TAXATION IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

This brief *amicus curiae* in support of Petitioner, Geoffrey, Inc. ("Geoffrey"), is filed by the Institute for Professionals in Taxation ("IPT").[1] IPT is a non-profit educational organization formed in 1976 under the laws of the District of Columbia. Its offices are located in Atlanta, Georgia. IPT's organizational purposes include the promotion of uniform and equitable administration of income, ad valorem and sales and use taxes. It has more than 4,500 members representing more than 1,400 businesses across the United States and in Canada. Represented within IPT's membership are numerous small businesses and most of the Fortune 500 companies. Member representation spans the industry spectrum, including aerospace, agriculture, manufacturing, wholesale and retail, communications, health care, financial, oil and gas, hospitality, transportation and other sectors.

Many IPT members have customers in Massachusetts and other states which have taken the position that they may constitutionally impose income and franchise taxes upon businesses that have no physical presence in such jurisdictions—

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[1] Pursuant to Rule 37.6, *amicus* Institute for Professionals in Taxation states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have consented to the submission of this brief in letters filed with the Clerk.

arguing that such businesses have an "economic nexus" with the state. Others have customers in jurisdictions considering such assertions of taxing jurisdiction through legislation or rulemaking. This issue is the most significant state and local tax question pending today. The associated tax and compliance cost implications, in the billions of dollars, are of special concern to small businesses because of the resulting disproportionate impact they occasion.

The constitutionality of the "economic nexus" theory of taxation raised here will not be resolved without this Court's intervention. The Court's declination to grant certiorari will only cause it to become a more costly and persistent issue. Conflicting state court decisions make manifest the uncertainty which attends this vital question, *to wit.*, what is the territorial limit of state taxing jurisdiction? Taxpayers and their advisors find themselves in the untenable position that the Commerce Clause, U.S. Constitution, Art. I §8 cl. 3 is being given differing applications from state to state. IPT sees the need for resolution by this Court as an urgent imperative and therefore earnestly supports Petitioner's request for review of the lower court's decision.

SUMMARY OF ARGUMENT

The decision of the Massachusetts Supreme Judicial Court below conflicts with decisions of other state courts on the question whether "economic

presence" meets the "substantial nexus" requirements of the Commerce Clause. The controversy is national in scope, the financial stakes very substantial, and the prospects for resolution without this Court's involvement extraordinarily remote. The use of an "economic nexus" standard is without precedent from this Court and premised upon speculation over the relative burdens imposed by state sales and use taxes and state income taxes. If there is a different constitutional limit to the power of state and local governments' right to impose an income tax as opposed to a sales and use tax, the difference should rest upon a principled analysis. The values which the Court found the "physical presence" standard served in *Quill* apply with equal vigor to other taxes. The Commerce Clause demands more than a superficial comparison of hypothetical "types" of taxes. It looks to the practical effects of a given tax statute upon the maintenance of an unfettered national economy. The "substantial nexus" requirement is the principal means of limiting burdens that unduly interfere with free-flowing commerce. Giving that threshold jurisdictional requirement different meanings on a tax-by-tax basis invites a proliferation of standards by state and local government anxious to expand the reach of their taxes. It would virtually assure the formulation of third, fourth and other varieties of "substantial nexus" as states, cities and counties press newly-conceived theories to justify the imposition of their levies. There are thousands of state and local jurisdictions in a position to do so, with every incentive to find a means of exporting an

augmented tax burden. The logic, simplicity and fair-mindedness of the "physical presence" requirement would be replaced by ever-finer distinctions among different taxes—taxing gross receipts, for example, would require physical presence, but a state which could not reach those receipts could tax the associated income upon the basis of "economic presence."

The "economic presence" test is nothing more than a restated Due Process test, looking to the frequency and extent of the contacts between a business and a given taxing jurisdiction. "Substantial nexus" is concerned not with the sufficiency of such contacts but with the burdens a given tax creates upon interstate commerce. Left unrepudiated by this Court, the "economic nexus" theory will effectively eradicate the requirement of "substantial nexus" except as to use taxes and will render state geographic boundaries illusory as the territorial limit on a state's taxing jurisdiction. The Court should grant the Petition and reverse the decision below.

ARGUMENT

I. Review Should be Granted to Resolve Conflicting Rulings Addressing the Question of Whether the Commerce Clause Imposes Different Jurisdictional Limitations on a Tax-by-Tax Basis.

From a short statement by this Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), a jurisdictional firestorm was born, one that will not abate without the Court's intervention. The now familiar observation concerned the "substantial nexus" requirement of the Commerce Clause:

> Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation.

Id. at 314.[2]

That remark created a conflict, the continuation of which causes the unnecessary and wasteful

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[2] Insofar as the statement concerned income taxes: (1) it was dictum—a remark about whether or not some other form of "substantial nexus" might be required for taxes not at issue in *Quill*; and (2) it was not necessary to the Court's decision. Dictum repeated, as by the Massachusetts Supreme Judicial Court, is still just dictum.

expenditure of limited business and government resources. It would be difficult to overstate the significance of the issue. It imposes upon businesses across the United States billions in tax costs which could have a substantial negative impact upon the national economy and the ability of businesses to create new jobs. Moreover, it has spawned uncertainties for state governments, the courts, taxpayers, practitioners and academics—uncertainties that confound compliance and invite litigation in state after state.

The tension between the physical presence requirement enunciated by this Court in *Quill* for sales tax purposes and the "economic nexus" theory enunciated by various state courts, is the subject of innumerable analyses and commentaries. Citing numerous state court decisions, Professor Walter Hellerstein devotes almost 40 consecutive pages to the subject in the oft-cited treatise Hellerstein & Hellerstein, *State Taxation*, ¶6.11, and refers to the "enormous outpouring of commentary" about this topic. *Id.* at ¶6.11(3), fn. 234. In addition to the many articles cited, there are numerous other legal, accounting and business periodical treatments,[3] and

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[3] See, e.g., Kulwicki, L., *Continuing State Trends in Nexus Enforcement After Quill—The Struggle to Define 'Substantial Nexus'*, 6 State Tax Notes 345 (1994); Hammack, J.M., *Taxing Out of State Entities with Intangible Assets: What Hath Geoffrey Wrought?*, 5 J. Multistate Tax'n 112 (1995); Cronin, J. et al., *Economic Nexus: A Case Study*, 14 STN 535 (1998); Langstraat, C.J. et al., *Economic Nexus: Legislative Presumption or Legitimate Proposition?*, 14 Akron Tax J. 1 (1999); Ervin, R.T., *State Taxation of Financial Institutions:*

the subject is repeatedly explored in programs sponsored by business and tax organizations and by government organizations, *e.g.*, the Federation of Tax Administrators and the Multistate Tax Commission.

More importantly for purposes of this Court's jurisdiction, there are conflicting state court decisions. The Petition does a thorough job of detailing those conflicts and it would serve no purpose to repeat that account here. IPT would only offer this additional observation—that the decisions declining to apply the physical presence test as a jurisdictional threshold for state income and franchise tax purposes rest principally upon the absence of any explicit statement from this Court that "substantial nexus" requires it. They thus reflect no principled or affirmative rationale for using one Commerce Clause standard for sales and use taxes and a diminished Commerce Clause standard for income taxes, but reflect, instead, opportunism facilitated by what is, at most, a negative implication from this Court's dictum.

Will Physical Presence or Economic Presence Win the Day?, 19 Va. Tax Rev. 515 (2000); Donnelly, G., *States of Confusion*, 16 CFO 54 (2000);); French, D., *Nexus—Between a Rock and a Hard Place on Taxes*, 38 Franchising World 51 (2006); Wells, J.T. et al., *Nexus and FIN 48: States of Flux*, 204 J. of Accountancy 80 (2007); VanLeuven, M. et al., *Economic Nexus and the Uncertainty of the Quill Physical Presence Test*, 38 Tax Adviser 322 (2007); Berger, C., *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, 26 J. State Tax'n 29 (2008); Schadewalde, M.S., *FIN 48 Forces Companies to Wrestle with Uncertain State Nexus Standards*, 78 CPA Journal 42 (2008).

Typical of the reasoning is this from the Illinois appellate court's opinion in *Borden Chemicals and Plastics, L.P. v. Zehnder*, 726 N.E.2d 73, 80 (Ill. Ct. App. 2001), an income tax case:

> Plaintiff argues that in *Quill*, the Supreme Court 'left open' the question of whether a physical presence is required in order to satisfy the substantial nexus requirement in other tax cases. We disagree. As the *Quill* court noted, 'concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement.' [citation omitted]. Thus, the physical presence requirement of *Quill* is inapplicable in the instant case.

A similar line of thought is found in *Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 123 (La. Ct. App. 2008):

> Therefore, the language in *Quill* impliedly suggests that the physical presence requirement is limited to the area of sales and use taxes and does not apply to the

> imposition of other state taxes.

Likewise in *General Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1028-29 (Wa. Ct. App. 2001), the court said of the *Quill* decision:

> The Court was careful to note, however, that in its review of other types of taxes, it has not articulated the same physical presence requirement as stated for sales and use taxes. . . . The tax at issue here is neither a sales or use tax . . . . We decline to extend *Quill's* physical presence requirement in this context.

The opinions proceed, then, from the premise that since the *Quill* decision is equivocal about the applicability of physical presence as a "substantial nexus" dictate beyond sales and use taxes, some different, and lower standard, must apply to state income taxation.[4] This approach turns what the

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[4] Florida's tack is reflective of a related tendency by some states—to treat the Court's denial of certiorari in other cases as establishing a new constitutional standard. The Florida Department of Revenue amended its corporate income tax rules after this Court declined, in late November 1993, to grant certiorari in *Geoffrey, Inc. v. So. Carolina Tax Com'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993). Without any relevant change in the underlying statute, the amended rule asserted that corporations would be subject to

Court has *not* said into a new, and variable, constitutional principle that dramatically expands the states' jurisdiction to tax. It ignores the fact that there are two things that the Court has not explicitly said: it has not expressly said that physical presence is required as a jurisdictional prerequisite to the imposition of a state income tax, and it has not said that states may levy such taxes in the absence of the taxpayer's physical presence in the taxing jurisdiction. At best, from that perspective, the Court simply has not ruled upon the question, one way or the other. What is clear, however, is that all the tax cases in which this Court has found that "substantial nexus" exists, whether entailing sales, income, franchise, or other taxes, have reflected physical presence by the affected taxpayer. This is a matter the Court itself took note of in *Quill*, 504 U.S. at 310. The observation, which implies a single Commerce Clause standard for all taxes, is one which the Massachusetts Supreme Judicial Court and other lower courts have entirely disregarded.

As a corollary, the decisions accepting the "economic nexus" theory for state income taxation fail to cite instances of the Court applying different Commerce Clause standards (or other constitutional safeguards for that matter), tax-by-tax . There are numerous examples to the contrary, in which the Court has applied the same standard across tax types. The Due Process jurisdictional requirements

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Florida income tax, even in the absence of physical presence, for "selling or licensing the use of intangible property in Florida for taxable years beginning on or after January 1, 1994."

for the prescribed "minimum connections," by way of illustration, have been applied in the context of various levies. See, e.g., *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954) (use tax), *Allied-Signal, Inc. v. Director, Div. of Tax'n*, 504 U.S. 768 (1992) (income tax); and *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991) (Michigan Single Business Tax, a value-added tax). Similarly, the Commerce Clause prohibition against discriminatory taxation of interstate commerce has been applied, using the same standards for all tax types, to property taxes, *Camp Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564 (1997); vehicle flat taxes, *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987); gross receipts taxes, *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984); telecommunications excise taxes, *Goldberg v. Sweet*, 488 U.S. 252 (1989); sales tax, *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (U.S. 1995); intangibles taxes, *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996); and income taxes, *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), among others. The one constant among all these cases, both state court cases and United States Supreme Court cases, is that each starts its Commerce Clause discussion with *Complete Auto*.

If the underlying basis for applying different constitutional theories to different taxes is that an income tax imposes a lesser burden than collection of use tax, that premise is totally theoretical. *Kmart Properties, Inc. v. Tax. And Rev. Dep't*, 131 P.3d 27, 35 (N.M. Ct. App. 2001). While, in *Kmart*, the court speculated about the relative burdens created by the

two taxes, speculation is not fact. There the court posits that state income taxes are usually payable once a year (ignoring requirements for estimated tax), at a single rate, to one jurisdiction, thereby suggesting such taxes reflect a lesser burden than use taxes, as described by this Court in *Quill*. There is no indication, however, that the *Kmart* court based its speculation upon any actual evidence comparing the burdens imposed by sales and use taxes with the burden imposed by state and local income taxes. The *Quill* opinion reflects no such findings or judgment.

Moreover, a compelling case can be made that the filing of state and local income tax returns and associated payment obligations is *at least* as, if not more, burdensome an obligation than the filing of state and local sales tax returns and associated collection and payment obligations. There is the obvious and very real difference that the income tax taxpayer is the obligor of the tax, not simply an agent collecting it from a customer and remitting it to the taxing jurisdiction. Comparing the burdens between the two taxes, this fact alone argues forcefully against the conclusion that collection of use tax creates the heavier burden.

Nor is it clear that subjecting a business to sales and use taxes mean that the business has to contend with more jurisdictions. One 2007 survey documented approximately 3,300 state and local tax jurisdictions that levy income, franchise and gross receipts taxes.[5] Thousands of others have the power

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[5] 'State and Local Jurisdictions Imposing Income, Franchise

to impose such taxes, and businesses would be required to gauge their amenability to such taxes based upon a multiplicity of divergent views as to what constitutes "economic nexus." The same would be true of the countless details which compliance with such taxes would demand.

State income and franchise tax requirements vary widely in such matters as types of returns (combined, consolidated, separate), parties required to join in a group return, conditions for moving from group returns to separate returns, issues arising from changes in the group (acquisitions, mergers and divestitures), types of organizations subject to tax, including issues as to partnerships, S corporations, and other pass-through entities, intercompany transactions, filing deadlines, extensions, electronic filing and payment requirements, estimated tax payments, and issues associated with federal audit adjustments and amended returns. The states use substantially different additions and subtractions to build locally-specific tax bases that vary from federal taxable income and from one another, for example, net operating loss carryovers and carrybacks. Another example is that some states "decoupled" from bonus depreciation offered at the federal level[6] while others did not.

As the Court is well aware, the states employ differing, tailored apportionment formulas to

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and Gross Receipts Taxes on Businesses, Ernst & Young, LLP, March 7, 2007".

[6] See, e.g., Fla. Stat. §220.03(3)(b) (2008).

determine their respective shares of multistate income and apply different rules for the calculation of the factor or factors used to apportion such income. Receipts to be included in the sales factor, for example, may be sourced to the jurisdiction where the costs of performance underlying the income predominate, or the receipts can be allocated among the jurisdictions where such costs are incurred, or the receipts could be sourced to the "market" jurisdiction. The components and calculation of property and payroll factors also vary from one jurisdiction to another. Apart from some regular apportionment formula, businesses may be required to contend with special industry-specific apportionment requirements, as well as demands from taxing authorities for case-by-case variations of the applicable apportionment formula(s) that such authorities believe better reflect the income properly attributable to their respective jurisdictions. The abandonment of the "physical presence" standard would subject businesses to these and thousands of additional complexities, to say nothing of the attendant audits, protests, appeals, and litigation, in jurisdictions maintaining the right to tax based upon some locally-nuanced "economic presence" test.

This analysis clearly demonstrates that there is no principled or rational basis for the conclusion that an income tax imposes a lesser burden than a sales tax. Accordingly, a different constitutional standard should not apply to an income tax than applies to a sales tax.

Furthermore, giving "substantial nexus"

different meanings, depending upon the tax being considered, is wholly illogical. Sales and use tax is surely not unique at the constitutional level. Closely related are gross receipts taxes imposed by states like New Mexico, Washington and Ohio. The New Mexico gross receipts tax is imposed upon the gross receipts of persons doing business in New Mexico, but the tax may be passed through to the consumer.[7] Even though a New Mexico appellate court adopted the "economic nexus" theory for the state's income tax, the court acknowledged that *Quill's* "physical presence" requirement governed its gross receipts tax.[8] The decision would thus interpret the "substantial nexus" prong of *Complete Auto* to require physical presence as a prerequisite to imposition of gross receipts tax, even though the business is the party being taxed and under no obligation to collect that tax from its customers. This analysis thus concedes that "physical presence" is a constitutional requirement beyond sales and use taxes—and that this jurisdictional limitation is not exclusively coupled with the responsibility of acting as a collection agent for the state.

If the Commerce Clause demands "physical presence" for the imposition of gross receipts taxes imposed upon businesses, what faulty logic would say an attenuated standard like "economic presence" suffices where other taxes imposed upon the same business are concerned? Such a rule invites the

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[7] http://www.tax.state.nm.us/oos/GrossReceiptsTaxFAQ.pdf.

[8] *Kmart Properties, Inc. v. Tax. And Rev. Dep't*, 131 P.3d 27, 35-36 (N.M. Ct. App. 2001)

implausible conclusion that a given business' income from sales into a given jurisdiction where it has no physical presence could be constitutionally taxed but that tax could not be imposed upon the gross receipts giving rise to that very income. The same business activity yields both the gross receipts and the associated income. The gross receipts are, in fact, a subset of such income.[9] Distinguishing between the two taxes, both imposed upon the business, for "substantial nexus" purposes would mean that the gross receipts fall beyond the state's taxing jurisdiction but the related income within it. If the Commerce Clause "concerns about the effects of state regulation upon the national economy" and the included requirement of "substantial nexus," which the Court has explained is "a means for limiting state burdens upon interstate commerce,"[10] embrace such unlikely distinctions, it is not because logic dictates that result.

For the same reason, the "economic nexus" contention fails to square with the Court's directive that the Commerce Clause be applied upon the basis of the "practical effect" of the tax.[11] Any fair-minded appraisal of the economic realities can lead to no conclusion other than that a gross receipts tax and an income tax are similar. The same business activity gives rise to both the gross receipts and the

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[9] See, line 1a of Form 1120, U.S. Corporation Income Tax Return, calling for the entry of "gross receipts or sales" in the calculation of taxable income.

[10] *Quill*, *supra* at 313.

[11] *Complete Auto*, *supra* at 279.

corresponding income so that the two taxes will affect such activities with equal force. The two taxes are thus alike in terms of their effect upon a free-flowing national economy. Any proposal to distinguish a use tax as an "indirect" tax (one payable by the seller only for failure to collect the same from the purchaser) from a gross receipts or income tax as a "direct" levy would be a step backwards to the type of semantic formalism the Court has clearly repudiated. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288-89 (1977).

Finally, the sanctioning of two drastically different constitutional meanings of "substantial nexus," one for sales and use taxes and a second for state income taxes, patently invites the creation of additional jurisdictional standards for other taxes. The rationale by which an alternative standard is adopted for state income taxation would be a clear invitation to taxing agencies and taxpayers to conceptualize more rigorous or relaxed thresholds for other types of taxes, predicated upon asserted differences between the nature or quantum of burdens to which affected businesses are subjected. The proliferation of such alternative formulations, with a third "substantial nexus" test for sundry flat taxes, a fourth for a Texas Margins Tax, Tex. Tax Code §171.0001 *et seq.*, another for an Ohio Commercial Activity Tax, ORC §5751.01 *et seq.*, another for the Michigan Business Tax, MCL §208.1101 *et seq.*, and the like, is a virtually certain offspring of that first step away from the single "bright-line" test thus far articulated. The Court should grant the Petition and take this opportunity

to say what it has not made explicit to this point—that the same salutary purposes which are served by using the "physical presence" standard for state and local sales and use taxes are present when delimiting the power of state and local governments to impose income and other taxes.

II. The Alternative "Economic Presence" Test Is Unworkable, Unduly Burdens Interstate Commerce, and Renders State Boundaries Immaterial as a Limit upon the Reach of a State's Taxing Powers.

The Massachusetts Supreme Judicial Court referred to its decision of the same date in *Capital One Bank v. Commissioner of Revenue*, 899 N.E.2d 76 (Mass. 2009) as "controlling," *Geoffrey, Inc. v. Commissioner of Revenue*, 899 N.E.2d 87, 88 (Mass. 2009). The *Capital One* decision principally relies upon the analysis of the West Virginia Supreme Court of Appeals in *Tax Com'r of State v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W.Va. 2006), *cert. denied, FIA Card Services N.A. v. Tax Com'n of W. Va.*,127 S.Ct. 2997 (2007). The *MBNA* opinion did not rely upon the presence of intangibles in the taxing jurisdiction. Instead, it rejected the "physical presence" test, calling it out-of-date and held that "a significant economic presence is a better indicator of whether substantial nexus exists for Commerce Clause purposes." *Id. at 234.* As formulated by that court, the "economic presence" test "requires that an entity's contacts with the state be more frequent and systematic in nature." *Id.* The "contacts" referred to are subsequently explicated by the court as follows:

> [T]his Court has no trouble concluding that MBNA's systematic and continuous business activity [direct mail and telephone solicitation of credit card customers] produced significant gross receipts attributable to its West Virginia customers which indicate a significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto*. [citations omitted]

The "economic presence" test thus would look at the contacts between the subject business and the state, rather than to the burdens imposed upon the business by the tax at issue. The substantial nexus requirement, however, is not a test of the level of contacts, no matter how frequent or systematic; the sufficiency of such contacts is the concern of the Due Process Clause. Rather, as the Court has made clear, substantial nexus is "*a means for limiting state burdens on interstate commerce.*" *Quill*, 504 U.S. at 313 (emphasis added). The analysis of the West Virginia Supreme Court of Appeals, and thus of the Massachusetts Supreme Judicial Court in *Capital One* and the instant case, adopting an "economic presence" approach, is fundamentally flawed because it forsakes any inquiry into the burden that the levied tax imposes upon the national economy.

The decision below improperly substitutes the Court's Due Process Clause test for the Commerce Clause test. The "economic presence" standard merely reaches the due process inquiry and goes no further. It therefore fails as an interpretation of that Commerce Clause prerequisite.

As this Court recognized in *Quill*, physical presence is a "bright-line rule [that] furthers the ends of the dormant Commerce Clause." 504 U.S. at 314. The test is equitable, simple for a business of any size to comprehend and predict, and easy to enforce. Importantly, the test also favors economic growth. It allows a taxpayer to report and pay taxes in fewer states, which means less money spent complying with tax laws and in litigation, and more money to invest in labor and capital. Further, it permits a business to determine with confidence, before entering a jurisdiction, whether it wants to be subject to taxation and incur the costs associated with doing business there (such as the likely need to keep multiple records, meet multiple filing requirements, and engage in multiple interactions with regulators). Our national economy plainly benefits from the relative simplicity of the bright-line physical presence rule—and that is as true of income tax statutes as of sales tax laws.

In contrast, as a practical matter, the so-called economic presence "test" is no test at all. The standard adopted by the West Virginia Supreme Court of Appeals in *MBNA* is particularly amorphous and arguably would allow for the imposition of income taxes upon mere evidence of consumers for

the services of a business, the derivation of income in any form, or even advertising directed at a state where the business has no tangible physical presence.

IPT's concern with the economic presence "test" is perhaps best demonstrated by its application to potential tax claims that its members and others are likely to face. Consider these three scenarios:

1. A professor from the University of Florida recognized as the nation's leading state and local government financing expert ("Expert") forms a consulting company to provide services to state and local governments throughout the United States. Expert never performs any services outside Florida and has no physical presence in any other state. All communications between Expert's company and its clients are performed electronically. Expert company's only contacts with states other than Florida is that its clients are located in the other states. Based upon an "economic presence" standard, in addition to Florida where Expert's company maintains physical presence, all other states where its clients are located could reasonably argue that Expert's company "systematically" and "purposefully" exploits their markets and thus has substantial nexus permitting imposition of income taxes by them.

2. A small businessman in New Jersey owns a car wash ("Car Wash") that advertises on Philadelphia radio and television stations and in Philadelphia newspapers that its rates for a car wash, detailing,

and other services are the lowest in the region. Car Wash has no physical presence in Pennsylvania. Thousands of Pennsylvania motorists pass Car Wash each weekend when headed east to the New Jersey beaches and Atlantic City, and Car Wash earns tens of thousands of dollars each year from these Pennsylvania residents. Based upon an "economic presence" standard, the Commonwealth of Pennsylvania could reasonably argue that Car Wash's "systematic" and "purposeful" efforts directed at enticing the citizens of Pennsylvania to purchase its services provides substantial nexus allowing Pennsylvania to impose income tax liability on Car Wash.

3. A neurologist at a leading hospital in Wilmington, Delaware, ("Doctor") regularly engages in remote "telemedical" examinations of stroke patients who are brought into emergency rooms in rural hospitals throughout the mid-Atlantic United States. The emergency room physicians electronically transfer patient CT scans and other data to Doctor, who reviews the materials on his computer in Delaware. Doctor and the emergency room physicians then confer by telephone or by videoconferencing link regarding diagnosis and treatment. Despite having no physical presence in any state but Delaware, all of the states where Doctor's "telepatients" are located could reasonably argue based upon an "economic presence" standard that Doctor has engaged in a "systematic" and "purposeful" direction toward those states that provides substantial nexus for income tax liability purposes.

Each of these scenarios involves an expansion of state taxing jurisdiction well beyond constitutional bounds. The resulting burdens upon interstate commerce will only increase as our national economy becomes more dependent upon the provision of information and services and as more states see the potential to expand their tax bases by adopting some variety of "economic presence" as the only limit on their taxing authority. *See e.g.*, Maine Tax Alert, Vol 18, No. 2, February 2008 ("[Maine Revenue Services] considers taxpayers with economic nexus alone to be subject to Maine's income tax laws."); and Oregon Rule 150-317.010(2) ("Substantial nexus exists where a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer and may be established through the significant economic presence of a taxpayer in the state.") The effects on small businesses would be particularly destructive.

Supporters of an "economic presence" standard argue that businesses benefit from the existence of a viable economic market in the states in which they have customers, and thus should be expected to pay income taxes there. This argument proves that "economic presence" is nothing more than the imposition of taxes against out-of-state business activity in exchange for the states doing what they ought to, and would be doing in any event: making their state part of the national marketplace for goods and services.

The taxation of non-resident individuals and entities is not easily restrained by political processes within the taxing state, as a state has every

incentive to export its tax burden and interpret its laws aggressively to reach as many out-of-state taxpayers as possible. The "economic presence" theory is such an attempt to ignore state boundaries in the zeal to find new revenue sources. It would effectively render the geographic limits set by a state's borders wholly irrelevant for Commerce Clause purposes where taxation is concerned.

Physical presence, by contrast, confines a state's taxing powers to its borders, circumscribing the reach of a tax to businesses that, by reason of their presence, are significantly adding costs that government would not otherwise incur. The Court should grant the Petition for the purpose of repudiating the "economic nexus" theory and making explicit the requirement of physical presence under the substantial nexus prong of the Commerce Clause.

CONCLUSION

For the foregoing reasons, this Court should grant the Petition and reverse the decision below.

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Dated: April 28, 2009